United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-1617

B

IN THE

United States Court of Appeals

For the Second Circuit

O/S

ESTATE OF DAVID SMITH, DECEASED, IRA M. LOWE, CLEMENT GREENBERG, ROBERT MOTHERWELL, Co-executors,

Petitioners-Appellants,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

On Appeal from the United States Tax Court

REPLY BRIEF FOR PETITIONERS-APPELLANTS

SULLIVAN & CROMWELL
48 Wall Street
New York, New York 10005
and
IRA M. LOWE
60 East 42nd Street
New York, New York 10017
Attorneys for Petitioners-Appellants

M. BERNARD AIDINOFF
HENRY CHRISTENSEN III
LAURIE L. MALMAN
Of Counsel

September 9, 1974

3

TABLE OF CONTENTS

TABLE OF AUTHORITIES

United States Court of Appeals

For the Second Circuit

Estate of David Smith, Deceased, Ira M. Lowe, Clement Greenberg, Robert Motherwell, Co-executors,

Petitioners-Appellants,

against

Commissioner of Internal Revenue,

Respondent-Appellee.

REPLY BRIEF FOR PETITIONERS-APPELLANTS

I

The errors of the Tax Court below in misinterpreting Treasury Regulations §20.2053-3(d)(2) are errors of law.

The appellee (hereinafter, the "Commissioner") seeks to avoid a reexamination of the Tax Court's decision by labelling it a factual determination which, under the authority of *Commissioner* v. *Duberstein,* 363 U.S. 278 (1960), should not be overturned unless clearly erroneous (Comm. Br., 14).[1]

---

1. "Comm. Br." references are to the brief of the Commissioner, served August 21, 1974. "Est. Br." references are to the brief of the Estate, dated July 8, 1974. "R." references are to the parties' separately bound joint record appendix, filed with the Estate's brief.

Ira M. Lowe, Clement Greenberg and Robert Motherwell, in their capacity as executors of the Estate, are referred to as the "Executors."

The *Duberstein* test is not applicable to this case. In determining a decedent's taxable estate Section 2053(a)[2] provides a deduction from the gross estate for:

> "[S]uch amounts ... for administration expenses, ... as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered."

Treasury Regulations §20.2053-3(d)(2) provides that:

> "Expenses for selling property of the estate are deductible if the sale is *necessary* in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution." (emphasis added)

The issue before this Court is whether the Tax Court erroneously applied this regulations section in holding that the Federal estate tax deduction for commissions paid the Marlborough-Gerson Gallery Inc. (hereinafter, the "Gallery") by appellant (hereinafter, the "Taxpayer" or the "Estate") on sales of sculpture is limited to the exact amount necessary to raise cash to meet other administration expenses, debts and finally adjudicated estate tax deficiencies, rather than the full sales commissions allowed as necessary and proper estate administration expenses by the state probate court having jurisdiction over the estate. Taxpayer does not contest the Tax Court's findings of fact (the bulk of the facts on this issue were stipulated). Where the court below has misinterpreted the words of a statute or regulation, the appellate court is not bound by the "clearly erroneous" rule. *Evans* v. *Commissioner,* 264 F.2d 502 (9th Cir. 1959), *reversed on other grounds,* 364

---

2. All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

U.S. 92 (1960). Since the Tax Court arrived at its decision by erroneously interpreting the word "necessary" in Regulations §20.2053-3(d)(2), the issue presented for review is one of law, not fact. *Trust of Bingham* v. *Commissioner*, 325 U.S. 365 (1945).

Furthermore, even if the *Duberstein* test were applicable, the decision of the Tax Court is "clearly erroneous", since it ignores the facts of this case. This Estate consisted primarily of one asset, sculpture, which had a substantial but speculative and volatile value and which could only be liquidated gradually over a long period of time if forced sale discounts were to be avoided. Given these facts, the Tax Court and the Commissioner in his brief ignore the clear duty of the Executors to liquidate such portion of the sculpture as they determined necessary to adequately diversify the investments of the Estate and preserve its value and to provide for anticipated liabilities of the Estate, in particular possible estate taxes and related expenses. These duties were separate from the duties of the trustees under the Will to provide for the trust beneficiaries. The Executors incurred the disputed sale expenses as necessary steps in the course of their administration of the Estate and the expenses are deductible within the terms of Treasury Regulations §20.2053-3(d)(2). The decision of the Tax Court to the contrary is "clearly erroneous" and should be reversed.

II

All of the sculpture sales in question were made by the Executors in their capacity as Executors and within the scope of their power as Executors.

The essential thesis of the Commissioner's brief is that midway in their ongoing administration of the Estate the Executors suddenly lost the power to make further sales of sculpture in that capacity, so that all further sales became sales as trustees rather than as Executors (Comm. Br., 8, 15, 16, 19 to 23). Presumably this transition occurred upon that sale which brought in the final cash necessary to meet precisely what retrospect shows to have been the aggregate expenses and taxes of the Estate, even though at the time these sales were going on no one knew what those expenses and taxes would turn out to be.

The Commissioner offers no authority for the assertion central to his thesis (Comm. Br., 15 to 16), that the Executors had no power to sell sculpture beyond the minimum sales required to realize the exact amount of cash ultimately determined to have been necessary to meet the Estate's obligations. His only reference is an inappropriate one to the opinion below (R, 88a).[3] The Will on its face empowered the Executors to make all the disputed sculpture sales. Article Third provides in pertinent part:

> "Third: My Executors and Trustees shall take possession of my estate and are hereby given power

3. The Tax Court made no finding that the Executors were without power to complete the disputed sales. It erroneously concluded that they had no *duty* to sell further sculpture, as the Will authorized them to distribute sculpture in kind to the residuary trusts. However, the Executors still had a duty under New York law to sell the additional sculpture where they thought it prudent. *In re Clark's Will,* 257 N.Y. 132, 177 N.E. 397 (1931).

> to hold, manage, operate, control, sell, convey, lease, mortgage, encumber, renew encumbrances, and assign the said estate, or any part thereof, to collect all the rents, income and profits therefrom; to pay all taxes, insurance charges, necessary repairs and other proper expenses connected therewith; and with full power to sell and convey, from time to time, and to mortgage and encumber such parts of my property and estate, real or personal, including all of my works of art, as in their best judgment and discretion may be expedient. The proceeds derived from any such sale or sales shall be invested and reinvested from time to time in such securities and property, real or personal, as my Trustees may elect.
>
> In the disposal of my works of art and other property, real and personal, said Trustees shall have as full and unlimited power and discretion as if said trust property were their own absolute estate."

While it is evident from the powers given them in the Will that Smith expected the trustees to sell the bulk of his sculpture and to invest the proceeds of sale,[4] the Executors as well as the trustees had the express power under the Will to sell all of the sculpture. Moreover, New York law plainly empowered the Executors to sell *all* of decedent's sculpture, if they deemed it necessary and proper to do so. *Petersen* v. *Chemical Bank,* 32 N.Y. 21 (1865), at 45; *In re Heinze's Estate,* 224 N.Y. 1, 120 N.E. 63 (1918); New York Estates, Powers and Trusts Law §11-1.1(b)(5)(B).

The Commissioner cites a number of early New York cases[5] in which the courts were first establishing differ-

---

4. Had the Will not authorized distribution in kind to the trusts and gradual sale by the trustees over an extended period, New York law would have required the Executors to promptly sell all of the sculpture. See pages 9-10, *infra.*

5. *Drake* v. *Price,* 5 N.Y. 430 (1851); *Hurlburt* v. *Durant,* 88 N.Y. 121 (1882) and *Johnson* v. *Lawrence,* 95 N.Y. 154 (1884).

ences between executors and testamentary trustees in the attempt to determine when the same individual would be entitled to commissions both as an executor and as a trustee. These cases would be relevant if the trustees had sold the sculpture. See *Estate of Streeter* v. *Commissioner,* 491 F.2d 375 (3d Cir. 1974). They are not relevant here because the Executors sold the sculpture.

Matter of McDowell[6] and *Matter of Robinson,*[7] also cited by the Commissioner (Comm. Br., 20), represent New York's adherence to the rule that where the same individual is named both executor and trustee and is given a power in one capacity that he doesn't have in the other, he will normally be assumed to be acting in the capacity in which he has the power, if he acts without differentiating between his two roles.[8] Again, the decisions are not relevant. The Executors had the power as Executors to sell every piece of sculpture if they determined to do so.

The Commissioner has similarly misread Federal law by his reliance on the Third Circuit's decisions in *Sharpe's Estate* v. *Commissioner,* 148 F.2d 179 (3d Cir. 1945) and *Estate of Streeter* v. *Commissioner, supra.*

---

6. 178 App. Div. 243, 164 N.Y.S. 1024 (3d Dept. 1917).

7. 155 Misc. 855, 280 N.Y.S. 687 (Surr. Ct., N.Y.Co. 1935).

8. Other states have the same doctrine. *See McMahon* v. *Krapf,* 323 Mass. 118, 80 N.E.2d 314 (1948); *Brown* v. *Fidelity Union Trust Co.,* 135 N.J.Eq. 404, 39 A.2d 120 (1944); I A. Scott, The Law of Trusts, §6, at 60-61 (3d Ed. 1967). As these cases demonstrate, while a court may "approve" a transaction in such a situation, it will nevertheless determine whether the act was that of an executor or a trustee.

In *Sharpe's Estate* v. *Commissioner*, the decedent bequeathed his entire residuary estate to a trust which he had set up during his lifetime. The estate attempted to deduct for Federal estate tax purposes the estimated future commissions payable to the trustee of that trust during the period subsequent to the decedent's death. The trust had nothing to do with the decedent's estate and received the net remaining assets only after the estate's administration terminated. There was no evidence that a state court had allowed estimated trustee's commissions as an estate administration expense. The Third Circuit denied an estate tax deduction for those estimated future commissions.

Taxpayer does not seek a deduction for estimated expenses here, or for future ones—all sales with respect to which a deduction is sought have been completed. Taxpayer does not seek a deduction for the expenses of any sale completed by or on behalf of the trusts—all sales here were completed by the Executors during and in the course of their administration of the Estate.

The more recent decision of the Third Circuit in *Estate of Streeter* v. *Commissioner, supra,* contrary to the Commissioner's reading of the case, refines its decision in *Sharpe's Estate* and directly supports Taxpayer's claim to a deduction here. The decedent in *Streeter* left a substantial estate which included as one of its principal assets an "Americana Collection" of some 4800 books, maps and other historical manuscripts and objects. The decedent gave his executors no authority to dispose of his collection, instead bequeathing his entire collection to his trustees (who were the same individuals as the executors, as in

this case), directing them to sell it over time. The trustees did sell the collection and the executors attempted to deduct the expenses of sale as administration expenses. *Solely* because the sale had been completed by the fiduciaries in their capacity as trustees, rather than in their capacity as executors, the Third Circuit denied a deduction. The Court specifically noted that if the Will had authorized the executors to sell the collection, and if they had done so, the sale expenses would have been deductible. 491 F.2d at 378.

Here the Executors clearly had the power to sell such sculpture as they did sell. This is precisely the situation where the *Streeter* court would allow a deduction. The fact that the trustees were *also* empowered to sell sculpture is not relevant. The controlling fact is that the Executors had the power to sell the sculpture and they did. *Estate of Louis Sternberger*, 18 T.C. 836, 842 (1952), *aff'd*, 207 F.2d 600 (2d Cir. 1953),[9] *reversed on other grounds*, 348 U.S. 187 (1955).

---

9. The issue of the deductibility of selling expenses was not appealed.

III

The sales of sculpture were necessary to preserve the Estate and effect distribution and were also necessary for the payment of taxes and administration expenses within the meaning of Treasury Regulations §20.2053-3(d)(2).

Rather than focus the Court's attention on the false issue of the Executors' power to make the sales of sculpture, the Commissioner should have analyzed the sales expenses. He offers little if anything to rebut Taxpayer's demonstration that the Tax Court misinterpreted both the law and the facts in denying a deduction for all commission expenses. In erroneously contending that there was no "necessity" to sell decedent's sculpture under the regulations, the Tax Court in its opinion and the Commissioner in his brief cite only *one* fact—the fact that decedent's sculpture rose in value *after* the Estate's course of sales began. However, all of the testimony before the Tax Court indicated not only the volatile nature of the value of decedent's sculpture (R. 49a, 50a, 54a, 64a, 73a, 75a. See also Est. Br., 11 to 12), but also that the facts available to the Executors in 1965 and the duties imposed upon them required that an orderly course of liquidation begin immediately.

More important, as Taxpayer has demonstrated in its main brief, sculpture is by definition a speculative and improvident investment for an estate under New York law (Est. Br., 16). In 1965, New York defined by statute the investments legal for an executor or trustee. Works of

art were non-legal investments and there arises by law a presumption that these sales were necessary to preserve the value of the Estate. Only because the Will authorized the Executors to distribute sculpture in kind to the residuary trusts were they freed of the duty to dispose promptly of all of the sculpture. However, the fact that the Will authorized distribution in kind did not alter the Executors' obligation to sell the sculpture when and as they thought prudent. New York Estates, Powers and Trusts Law §11-2.2(a)(7); *In re Clark's Will,* 257 N.Y. 132, 177 N.E. 397 (1931). And the fact that the sales incidentally benefited the residuary trusts and the beneficiaries of those trusts is not important in determining whether the sales were necessary and proper steps in the administration of the Estate. *Estate of Park* v. *Commissioner,* 475 F.2d 673 (6th Cir. 1973); *Harry C. Porter, Transferee,* 49 T.C. 207, 225 (1967). See *Dulles* v. *Johnson,* 273 F.2d 362 (2d Cir. 1959), *cert. denied,* 364 U.S. 834 (1960). As the Sixth Circuit has recognized in *Estate of Park* v. *Commissioner, supra* at 676-77,

> "A prudent fiduciary should be and perhaps is required to prevent the loss of probate assets where it may safely be avoided. If the fiduciary on the basis of his sound judgment, as approved by the probate court, feels that the estate would benefit by the sale of the . . . [asset] (regardless of the wishes of the beneficiaries) the availability of the deductions under §2053(a) should not be denied because the respondent does not deem the sale to have been necessary."

The Commissioner's argument (Comm. Br., 17 to 18) that Taxpayer is not entitled to a deduction for the expenses of these sales as necessary steps to meet anticipated taxes and administration expenses also rests inappropri-

ately upon hindsight. He says only that in retrospect the taxes and administration expenses were not as great as they might have been. Any judgment of the Estate's actions must be based upon the facts known to the Executors in 1965 and when they received the Commissioner's Notice of Deficiency in 1969, not upon the determination made by the Tax Court in 1972. Even the Tax Court below (R, 89a) recognized that a court cannot use hindsight in judging what was necessary at the time. On the basis of the facts known to them at the time, the Executors' decision to sell as much sculpture as they did resulted from a proper, conservative estimate of their possible liabilities and of a possible fall in the sculpture's value. The Commissioner's attempted analogy in footnote 8 on page 18 of his brief to exorbitant attorneys' fees is inappropriate at best. Whether or not the taxes claimed by the Commissioner were exorbitant, they were taxes asserted to be owed to the United States by the Commissioner of Internal Revenue. Any taxpayer must be entitled to take a notice of deficiency seriously.

The Commissioner erroneously cites the decision of the Tax Court below (Comm. Br., 17) for the proposition that there was no need to sell the sculpture to anticipate the payment of taxes and administration expenses, because a ready market for the sculpture always existed. That is not at all what the Tax Court said. While the Tax Court disagreed with the Estate's analogy of the sculpture to perishable goods (R, 89a), the Tax Court explicitly found that a bulk sale of the sculpture would have realized a substantially smaller sum of money than gradual sale of sculpture over time (R, 77a). Thus the only prudent man-

ner in which the Executors could prepare for expenses was to anticipate them, because assets of the Estate were not the kind that could be sold overnight to realize cash. Federal law has long recognized that expenses incurred by an executor in anticipation of future estate taxes are deductible. *Hipp* v. *United States,* 72-1 U.S.T.C., ¶12,824 (D.S. Car. 1971); *Estate of Henry E. Huntington,* 36 B.T.A. 698 (1937).

The Commissioner also seems to rely on the fact that the Executors "vigorously contested" the issue of the sculpture's value until a decision was rendered by the Tax Court as evidence of there being no "necessity" to sell sculpture early in the administration of the Estate or even when the Estate was first presented with the Commissioner's Notice of Deficiency (Comm. Br., 17). The Executors could not possibly have known the outcome of their contest, and as prudent fiduciaries they were required to anticipate the worst.[10] Moreover, what would the Commissioner's position be if instead of contesting the Notice of Deficiency in the Tax Court the Estate had paid the asserted deficiency and instituted proceedings for a refund in the district court or the Court of Claims pursuant to section 1346 of Title 28 of the United States Code? Would the Commissioner assert in that case that the liability which Taxpayer was anticipating was exorbitant and that it was unreasonable for Taxpayer to incur expenses of sales in order to raise the cash to meet such

10. It is to be noted that of the entire $1,602,644.67 in sales commissions sought to be deducted by Taxpayer, only $299,300 were incurred after the initial decision of the Tax Court in February of 1972 and none were incurred after the government's time to appeal that decision expired.

a liability? A taxpayer cannot be placed in a different position with respect to the allowability of a deduction under section 2053 because he elects to initiate judicial proceedings in the Tax Court, rather than in the district court.

The Executors' motivations in determining to make the sales were not simple or based upon any one factor, because there were numerous things they had to consider. The record demonstrates that they were amply justified in their determination to sell such sculpture as they sold in order to prepare for anticipated liabilities of the Estate and to preserve its value for ultimate distribution. Likewise, their determination to distribute $1,392,491.69 to the residuary trusts from May 23, 1965 to April 30, 1970 was consistent with an orderly and prudent plan of estate liquidation and distribution, in this case taking into account the relative income tax liabilities of the Estate and the trusts. The Commissioner's implication in footnote 7 on page 17 of his brief[11] that since the Executors made these interim distributions they did not need to sell additional sculpture is unwarranted. If the Estate's eventual liability had exceeded the cash reserve retained by the Executors, under New York law the trustees would have had to return any cash needed to the Executors. See Surrogate's Court Procedure Act, §2215(3). More importantly, however, the Executors' course of sales and distributions indicated prudent and proper administration of the Estate's assets in the light of all their obligations. Whether the Ex-

11. The discrepancy between the two figures of $1,392,491.69 and $1,448,429.44 arises because before funding the trusts the Executors made a number of direct payments to or for the trust beneficiaries. See note 12, *infra*.

ecutors considered any one factor determinative when they resolved to sell the sculpture is not in evidence and not important. They had the power to make the sales. They had good reason to make the sales. The expenses of the sales are proper administration expenses, deductible under Federal and New York law.

IV

The commissions were properly allowed by the New York Surrogate's Court and they are deductible administration expenses.

The Commissioner wrongly attacks the two decrees of the New York Surrogate's Court on the basis that they approved support payments to the two infant daughters of decedent (Comm. Br., 21). The Surrogate's approval of the support payments was entirely proper. It "approved" those payments as distributions made to beneficiaries before the trusts were funded, not as administration expenses.[12] Any attempt by the Commissioner to ascribe meaning to that is quite inappropriate.

As Taxpayer has stated (Est. Br., 20), the interests of the New York Surrogate's Court and the Internal Revenue Service in examining payments which an executor claims as administration expenses are the same and the Commis-

12. These payments appear on a separate schedule of the account (Schedule E) having nothing to do with administration expenses, which are on Schedule C. Under New York law, income earned during the administration of a decedent's estate is payable pro rata to the beneficiaries of the residuary estate and to the beneficiaries of any testamentary trusts. New York Estates, Powers and Trusts Law, §11-2.1(d)(2). The income can be paid to the trustees or directly to the beneficiaries of a trust.

sioner cannot ignore state court proceedings. Taxpayer is not suggesting that the Federal taxing authorities blindly follow all state court decisions. However, the state court constantly examines administration expenses and, by the terms of Regulations §20.2053-1(b)(2), its decision with respect to the allowability of an administration expense is normally to be followed. The state court here examined the accounts and approved the sales in proceedings in which all parties were represented. The absence of a contest is of course relevant, but the decision of the New York Surrogate's Court is presumptively to be followed. *Union Commerce Bank* v. *Commissioner,* 339 F.2d 163 (6th Cir. 1964); *Dulles* v. *Johnson,* 273 F.2d 362 (2d Cir. 1959), *cert. denied,* 364 U.S. 834 (1960); *Commercial Nat. Bank of Charlotte* v. *United States,* 196 F.2d 182 (4th Cir. 1952); *Schmalstig* v. *Conner,* 46 F. Supp. 531 (S.D. Ohio 1942); *Estate of Louis Sternberger, supra.*

Moreover, the Commissioner would have the Court ignore the language of Section 2053(a), which provides a deduction for administration expenses "allowable by the laws of the jurisdiction ... under which the estate is being administered." The term "allowable" replaced the word "allowed" in 1954, making it clear that the primary concern is whether the expenses are proper under state law, regardless of formal probate actions. *Pitner* v. *United States,* 388 F.2d 651 (5th Cir. 1967); *Commissioner* v. *Bronson,* 32 F.2d 112 (8th Cir. 1929). Thus even if those proceedings were found to be procedurally inadequate here (and the Tax Court made no such finding), the Tax Court should have applied New York law in determining whether the expenses of sale were "allowable" under New York

law. The Tax Court did not even consider New York law. The evidence in the record clearly demonstrates that the expenses of sale were allowable as estate administration expenses under New York law and were properly allowed by the state court.

V

Regulations §20.2053-3(d)(2) must be read to allow a deduction for administration expenses allowable by state law, or the regulations section is imvalid.

In his final argument the Commissioner continues to misstate Taxpayer's position. Taxpayer maintains that Regulations §20.2053-3(d)(2) allows a deduction for sales expenses properly allowable under state law. Further, if that regulations section is read to deny a deduction for administration expenses allowable under state law, it is invalid. The Commissioner fails to support his erroneous view that Regulations §20.2053-3(d)(2) adds a substantive condition for deductibility beyond the statute's requirement that an administration expense be allowable under state law.

The Commissioner presents a novel interpretation of Regulations §20.2053-3(d)(2) which he attempts to support with the doctrine of statutory reenactment. Taxpayer acknowledges the general standards for reviewing Treasury regulations. However, as the dissent below made absolutely clear, the principle of statutory reenactment requires a finding that Congress both considered and approved the reading of a regulations section advanced by the Commissioner (R, 92a to 94a). Since the language cited from the

Senate Finance Committee's Report in 1954 (Comm. Br., 26) does not indicate that Congress even considered this regulations section, let alone the Commissioner's present view of it, the Commissioner's assertions are simply speculations which should not be given weight. *Mitchell* v. *Commissioner,* 300 F.2d 533, 538 (4th Cir. 1962).

Jackson v. *Commissioner,* 18 B.T.A. 875 (1930), cited by the Commissioner (Comm. Br., 25 to 26), has nothing to do with the Commissioner's reading of Regulations §20.2053-3(d)(2). In that case, the Board of Tax Appeals merely stated that the regulations section generally defining administration expenses was reasonable when read to deny a deduction for commissions paid to fiduciaries acting as trustees.

Likewise, none of *Pitner* v. *United States, supra, Commercial Nat. Bank of Charlotte* v. *United States, supra,* or *Ballance* v. *United States,* 347 F.2d 419 (7th Cir. 1965), furnish the support the Commissioner is looking for. In fact, contrary to his assertion (Comm. Br., 27) that only *Estate of Park* v. *Commissioner, supra,* supports the Estate, these cases in the Fifth, Fourth and Seventh Circuits sustain the proposition that Regulations §20.2053-3(d)(2) should not be read to deny a deduction for administration expenses properly allowable under state law. In *Pitner,* the decedent's estate had not been probated and no local court had examined the claimed deductions. The estate was governed by Texas law. After an exhaustive review of Texas law which found no cases on point, the Fifth Circuit stated:

> "In most instances the interest of the federal government in protecting its revenues will coalesce with the

> interest of the state in protecting its citizens, and the state law may be relied upon as a guide to what deductions may reasonably be permitted for federal estate tax purposes. In some cases, however, the state law on its face or in its application may not be responsive to the interests traditionally protected by the state. In other cases, such as the one before us, the state might justifiably feel that it had no interests to protect, and consequently fail to create rules to govern the situation one way or the other. When for any of these reasons state law fails in adequately representing the interest of the federal government, a framework still exists grounded in federal law defining the limits to which an expense may go and still be considered deductible for federal estate tax purposes." *Id.* at 659.

Contrary to the inference which might arise from the partial quotation of this passage at page 31 of the Commissioner's brief, *Pitner* could not possibly stand for the proposition that an expense which was allowable under state law is not allowable under section 2053. The Court tried to find state law on point but there was none. It then resorted to the law of other states—including New York—and allowed a deduction.

Likewise, the Commissioner's reference to *Ballance* v. *United States, supra* (Comm. Br., 29), is misleading. Under the 1939 Code, estate taxes were not an allowable estate tax deduction, and interest on overdue taxes was deemed part of the estate tax. In *Ballance* decedent's estate sought to deduct interest on overdue estate taxes and tried to circumvent the statute by contending that the interest expense was a general administration expense allowable under state law. The Court properly disallowed the de-

duction, because section 812 (the forerunner of section 2053) was simply overridden by sections 890 and 891 of the Code. This holding has nothing to do with the Commissioner's reading of Regulations §20.2053-3(d)(2). In fact, with respect to general administration expenses, the Court in *Ballance* squarely recognized that:

> "[T]he definition of 'administration expenses' in the treasury regulation as such expenses as are 'necessarily' incurred in the administration of the estate cannot serve to override the statutory provision (Section 812) authorizing the deduction of '[s]uch amounts * * for administration expenses * * * as are allowed by the laws of the jurisdiction * * * under which the estate is being administered'." *Id.* at 423.

Furthermore, despite the Commissioner's inference to the contrary, in *Commercial Nat. Bank of Charlotte* v. *United States, supra,* at 185 (Comm. Br., 13 and 26), the Fourth Circuit recognized that it had "[b]een the purpose of Congress to follow the state law in the allowance for administration expenses." The clear weight of authority agrees that under section 2053(a) and under Regulations §20.2053-3(d)(2) as properly interpreted state law is controlling. If the regulations are read to impose any standard for deduction in addition to the requirement of allowability under state law, they must be deemed invalid.

CONCLUSION

The Estate is entitled to a deduction for the full amount of the commissions paid the Gallery. Accordingly, the decision of the Tax Court should be reversed and the case remanded.

Respectfully submitted,

SULLIVAN & CROMWELL
48 Wall Street
New York, New York 10005
and
IRA M. LOWE
60 East 42nd Street
New York, New York 10017
Attorneys for Petitioners-Appellants

M. BERNARD AIDINOFF
HENRY CHRISTENSEN III
LAURIE L. MALMAN
Of Counsel

September 9, 1974

ADDENDUM

Additional Statutes Discussed in Appellants' Reply Brief

New York Estates, Powers and Trusts Law

SECTION 11-2.2. POWER TO INVEST.—(a) Investment of trust funds.

* * *

(7) No fiduciary holding funds for investment shall be liable for any loss incurred with respect to any investment not eligible by law for the investment of trust funds, if such ineligible investment was received by such fiduciary pursuant to a decree of court or the terms of the will, deed, or other instrument creating the fiduciary relationship, or if such ineligible investment was eligible when received or when the investment was made by the fiduciary; provided such fiduciary exercises due care and prudence in the disposition or retention of any such ineligible investment.

New York Surrogate's Court Procedure Act

SECTION 2215. DECREE FOR PAYMENT AND DISTRIBUTION.

* * *

(3) If any creditor or person interested has received estate assets in excess of the amount determined on the settlement of the account to be due him the court is authorized to direct in the decree repayment by him of the excess to the fiduciary of the estate or otherwise as justice shall require and the exercise of such power by the court heretofore is confirmed.

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

- x

ESTATE OF DAVID SMITH, DECEASED, IRA M. LOWE, CLEMENT GREENBERG, ROBERT MOTHERWELL, CO-EXECUTORS,	:	
Petitioners-Appellants,	:	
-against-	:	File No. 74-1617
COMMISSIONER OF INTERNAL REVENUE,	:	
Respondent-Appellee.	:	

- x

STATE OF NEW YORK)
: SS.:
COUNTY OF NEW YORK)

DOROTHY M. SCHLIP, being duly sworn, deposes and says that she is over the age of twenty-one years; that she is employed by the firm of Sullivan & Cromwell, attorneys for Petitioners-Appellants; that on the 9th day of September, 1974 she served the within Brief on George Wolf, Esq. by depositing two true copies of the same securely enclosed in a postpaid wrapper in the Post-Office Box regularly maintained by the United States Government at 48 Wall Street, Borough of Manhattan, City and State of New York, directed to said George Wolf, Esq., Tax Division, Department of Justice, Washington, D.C. 20530.

Dorothy M. Schlip

Sworn to before me this
9th day of September, 1974

George A. Scholze
Notary Public

GEORGE A. SCHOLZE
Notary Public, State of New York
Residing in Nassau County
Nassau Co. Clk's No. 30-3526250
Certificate Filed in
New York Co. Clk's Office
Commission Expires March 30, 1975